COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF THELMA WASTE CONTROL, INC. FOR A RATE ADJUSTMENT PURSUANT TO THE ALTERNATIVE RATE FILING PROCEDURE FOR SMALL UTILITIES	))))	CASE NO. 95-236

O R D E R

Thelma Waste Control, Inc. ("Thelma Waste Control") applied pursuant to 807 KAR 5:076 for authority to increase its rates by approximately 35.5 percent to produce additional annual revenues of $7,715. By this Order, the Commission establishes a unified rate for the sewer utility which produces additional annual revenues of $5,001.

Thelma Waste Control is a private corporation that provides sanitary sewer service to the Hughes and Fraley Subdivisions of Johnson County, Kentucky. It has operated the sewage treatment plants that serve those subdivisions since 1993. As of December 31, 1994, it served a total of 49 customers.

On June 15, 1995, Thelma Waste Control filed its application for a rate adjustment. The following persons were permitted to intervene: Mark and Becky Anuszkiewicz, Mark and Sheila Graham, Barry and Sue Love, Rex and Donna Martin, Tom and Janie Murphy, Glenda Owens, Larry and Marcella Pack, Jimmy and Gayle Soard, and John and Bonnie Swisher. All intervenors are customers of Thelma Waste Control's Hughes Subdivision Treatment Plant.

After Thelma Waste Control submitted its application, Commission Staff prepared a written report on the application and its review of the utility's financial records. A hearing on the proposed rates was held on March 8, 1996 at the Commission's offices in Frankfort, Kentucky. Upon completion of the hearing, this case stood submitted for decision.

TEST PERIOD

The Commission has used the 12-month period ending December 31, 1994 as the test period for determining the reasonableness of the proposed rates. In using this historic test period, the Commission has given full consideration to appropriate known and measurable changes.

OPERATING REVENUES

Thelma Waste Control reported revenues of $20,892 from rates during the test year. In its application, Thelma Waste Control reported 49 customers. Its Fraley Subdivision Treatment Plant serves 40 of these customers. Its Hughes Subdivision Treatment Plant serves the remainder. Based on this number of customers and the utility's current rates, the Commission finds that Thelma Waste Control's normalized test period revenue from rates is $21,709.[1]

---

[1]

40 customers x $31.30 x 12 months	=	$15,024.00
9 customers x $61.90 x 12 months	=	$ 6,685.20
Total Revenue:		$21,709.20

OPERATING EXPENSES

Thelma Waste Control incurred test-period operating expenses of $21,043. It proposes to reduce this amount by $3,661. The proposed adjustments are discussed below:

Electric Power. Thelma Waste Control proposes to reduce its actual test-period electric expense of $2,934 by $934. The utility having offered no explanation for this proposed reduction, the Commission finds that the test-period expense should be used for rate-making purposes.

Chemicals. Thelma Waste Control proposes to reduce its test-period chemicals expense of $4,771 by $2,384. In support of this proposed adjustment, it states that the utility plant operator's use of chlorine tablets was excessive and that its plants can operate within legal limits using less chlorine. Commission Staff reported that the proposed adjustment is reasonable. Accordingly, the Commission finds that Thelma Waste Control's annual chemicals expense for rate-making purposes should be $2,387.

Miscellaneous Supplies and Expenses. Thelma Waste Control proposes to reduce the test period expense of $899 by $199. It has provided neither explanation nor supporting evidence for its proposed adjustment. The Commission, therefore, rejects the proposed adjustment.

During the test period, Thelma Waste Control paid a $600 invoice from Beckman Environmental Services Company of Cincinnati for services rendered in 1991. Since the payment was for an expense outside the test period, the Commission finds that this expense should be excluded for rate-making purposes. Therefore, annual miscellaneous supplies and expense of $299 has been included for rate-making purposes.

Outside Services. Thelma Waste Control proposes to reduce actual test-year outside services expense of $1,289 by $644. It provided neither explanation nor supporting evidence for its proposed reduction. In the absence of such evidence, the Commission finds that Thelma Waste Control's rates should be based on the test period level.

Amortization Expense. Thelma Waste Control proposes to increase amortization expense by $500 to cover the cost of a construction permit. Commission Staff testified that this expense was incurred to construct the utility's sewage treatment plants and is an extraordinary expense of a non-recurring nature. Accordingly, the Commission finds that the cost of the construction permit should be included in the sewage treatment plants' total cost and depreciated over the life of the plants. In this case, the appropriate amortization period would be 20 years. Accordingly, annual amortization expense of $25[2] has been included for rate-making purposes.

---

[2] $500 ÷ 20 years = $25 annually.

Interest on Long-Term Debt. Thelma Waste Control proposes to increase reported test-year interest on long-term debt expense of $5,460 by $446. The debt in question involves a $120,000 loan from the Kentucky Association of Counties Leasing Trust Program to finance the purchase of the utility's sewage treatment plants. The Commission finds that the level of long-term debt expense should be based upon a three-year average of the loan's interest payments. Based upon the loan's amortization schedule, the Commission finds that a three-year average (1995-1997) of interest, plus other fees (administrative, credit, and fiduciary) is $6,160[3] and that this amount should be included for rate-making purposes.

OPERATIONS SUMMARY

Based upon our review of the evidence, Thelma Waste Control's operating statement is as follows:

	Utility Proposal	Adjustments	Test Year Adjusted
OPERATING REVENUES	$ 20,892	$ 817	$ 21,709
OPERATING EXPENSES:			
Water Service	$ 180	-0-	$ 180
Electric Power	2,934	-0-	2,934
Chemicals	4,771	(2,384)	2,387
Misc. Supplies & Exp.	899	(600)	299
Treatment & Disposal	484	-0-	484
Routine Maint. Fee	2,600	-0-	2,600

---

[3]

1995 Interest Expense		$ 6,384
1996 Interest Expense		6,160
1997 Interest Expense		5,937
	Total	$18,481

$18,481 ÷ 3 years = $6,160 per year.

Customer Records	160	-0-	160
Off. Supplies & Other	445	-0-	445
Outside Services	1,289	-0-	1,289
Insurance	888	-0-	888
Depreciation	6,189	-0-	6,189
Amortization Exp.	-0-	25	25
Taxes Other Than Inc.	204	-0-	204
Total Operating Exp.	$ 21,043	$(2,959)	$ 18,084
OPERATING INCOME	$ (151)	$ 3,776	$ 3,625
OTHER DEDUCTIONS:			
Interest on L-T Debt	5,460	700	6,160
NET INCOME	$(5,611)	$ 3,076	$ (2,535)

REVENUE REQUIREMENTS DETERMINATION

The Commission has historically used an operating ratio approach[4] to determine revenue requirements for small, privately-owned utilities.[5] This approach is used because no basis for rate-of-return determination exists or the cost of the utility has fully or largely been recovered through the receipt of contributions. The Commission finds that this method should be used to determine Thelma Waste Control's revenue requirements.

The Commission finds that an operating ratio of 88 percent will allow Thelma Waste Control sufficient revenues to cover its reasonable operating expenses and to provide for reasonable equity

---

4 Operating Ratio is defined as the ratio of expenses, including depreciistion and taxes, to gross revenues.

$$\text{Operating Ratio} = \frac{\text{Operating Expenses} + \text{Depreciation} + \text{Taxes}}{\text{Gross Revenues}}$$

5 *See, e.g.*, Case No. 7553, McKnight Utilities Co. (Ky. P.S.C. Nov. 13, 1979).

growth. In calculating Thelma Waste Control's revenue requirement, the Commission has excluded interest expense from adjusted operating expenses and allowed only a dollar-for-dollar coverage. Using this methodology, an operating ratio of 88 percent results in a revenue requirement of $26,710.[6] The Commission accordingly finds that Thelma Waste Control should be permitted to increase its annual operating revenues by $5,001.[7]

RATE DESIGN

Thelma Waste Control proposes a monthly rate of $46 for customers of its Fraley Subdivision Treatment Plant and a monthly rate of $68 for customers of its Hughes Subdivision Treatment Plant. In its application, Thelma Waste Control failed to offer any explanation or to provide any supporting evidence for the disparate treatment of these customers.[8]

6

Adjusted Operating Expenses	$ 18,084
Operating Ratio	÷ .88
Required Operating Revenue	$ 20,550
Allowed Interest Expense	+6,160
Total Revenue Requirement	$ 26,710

7

Required Operating Revenue	$ 26,710
Minus: Normalized Test Period Revenue	$ 21,709
Required Revenue Increase	$ 5,001

8 Thelma Waste Control proposed to increase its rates to Fraley Subdivision Plant customers by 47 percent and to Hughes Subdivision Plant customers by only 10 percent.

Finding that Thelma Waste Control had not adequately supported its proposed allocation of costs between the sewage treatment plants, Commission Staff recommended that the utility's proposed rate design be rejected and a unified flat monthly rate be used instead. Commission Staff's principal objection to the proposed rate design was that the design was based upon Thelma Waste Control's proposed operating budget rather than historical cost information.

Attempting to address these criticisms, Thelma Waste Control presented at the hearing a statement of each treatment plant's operating costs and revenues for the test period. Unfortunately, the witness sponsoring this evidence had not reviewed the invoices or bills associated with the various expenses and he had no personal knowledge of the statement's preparation. Under cross-examination, he conceded that, for certain expenses such as taxes and licensing fees, the utility's method of allocation was not the most accurate.

The Commission supports the principle that utility rates should be cost based, and that in most circumstances each class of utility ratepayers should pay the costs which the utility incurs to provide that class with utility service. A separate rate for each subdivision treatment plant, if properly calculated, prevents cross-subsidization of utility rates. In this case, however, Thelma Waste Control has failed to show that its cost allocations are correct. It has failed to submit billing records and invoices which support its proposed allocation. Its use of utility plant cost to allocate certain expenses such as office supplies, chemicals, tax and licenses is inappropriate and without rational basis. In the absence of convincing evidence that the cost allocations are accurate and fair, the Commission finds that a unified rate of $45.43 per month should be charged.[9]

SUMMARY

After review of the evidence of record and being otherwise sufficiently advised, the Commission finds that:

1. Thelma Waste Control's adjusted test year revenues are $21,709.

2. Thelma Waste Control's adjusted test year operating expenses, excluding interest expense, are $18,084.

3. An operating ratio of 88 percent will provide Thelma Waste Control with sufficient revenues to cover its reasonable operating expenses and to provide for reasonable equity growth.

4. Based on an operating ratio of 88 percent and Thelma Waste Control's adjusted test period revenues and expenses, Thelma Waste Control should be permitted to earn revenues of $26,710.

---

[9]

Revenue Requirement	$ 26,710
Divide by Customers	÷ 49
Annual Revenue per Customer	$ 545.10
Divide by 12 Months	÷ 12
Monthly Bill	$ 45.43

5. The rates in Appendix A are the fair, just and reasonable rates for Thelma Waste Control and will produce annual revenues of $26,710 based on adjusted test-year revenues.

6. The rates proposed by Thelma Waste Control will produce revenue in excess of that found reasonable and should be denied.

IT IS THEREFORE ORDERED that:

1. The rates proposed by Thelma Waste Control are hereby denied.

2. The rates set forth in Appendix A are approved for service rendered by Thelma Waste Control on and after the date of this Order.

3. Within 20 days of the date of this Order, Thelma Waste Control shall file with the Commission revised tariff sheets setting forth the rates approved herein.

Done at Frankfort, Kentucky, this 15th day of April, 1996.

PUBLIC SERVICE COMMISSION

Linda K Breathitt
Chairman

Vice Chairman

Robert M. Davis
Commissioner

ATTEST:

Don Mills
Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 95-236 DATED APRIL 15, 1996.

The following rates and charges are prescribed for the customers in the area served by Thelma Waste Control, Inc. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

<u>Monthly Flat Rate</u>

$45.43 per customer